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India: Technology and Productivity -- Gandhi's Policy Themes

Summary

Prime Minister Rajiv Gandhi's interests in technology and productivity have revived economic liberalization efforts that began under Indira Gandhi but stalled during the past two years. His moves to ease government restrictions on private production and investment are so significant by Indian standards that press reports describe Indian businessmen as ''drunk with euphoria.'' His more cautious approach to changes in foreign trade policy probably reflects concern about forthcoming balance-of-payments strains as well as a continuing emphasis on self-reliance. Gandhi still intends the government to retain control of the economy but believes that less bureaucratic meddling and more competition in the private sector will spur modernization, limit corruption, and ease strains on the budget. Gandhi's economic reforms open new opportunities for ties with Western business. 25X1

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Since independence, Indian policymakers have regulated the economy through an extensive system of direct controls as well as a full range of macroeconomic policies. Even though a multitude of minor policy adjustments since 1980 has loosened bureaucratic bottlenecks, Rajiv inherited policies that protect most Indian businessmen from foreign and domestic competition and require them to seek government permission before increasing output beyond authorized ceilings. After Indira Gandhi was assassinated last fall, Indian businessmen enthusiastically anticipated further reforms from a young Prime Minister with technical training and a computer hobby. Rajiv Gandhi's initial moves have fueled an unprecedented atmosphere of optimism among corporate leaders.

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- ''Improvement in productivity, absorption of modern technology, and fuller utilization of capacity must acquire the status of a national campaign.''
- ''We don't want controls, we want control (of the direction of the economy)...Controls lead to all the corruption, to all the delays.''
- To businessmen: The ''problem will not be with government constraints...this government (will be) moving faster than you.''

Rajiv Gandhi

Benefits for Private Industry

The new emphasis on technology and productivity is reflected in significant relaxation of government restrictions on private industry:

- Except for large industrial groups and foreign companies, licenses are no longer needed to establish or expand capacity outside of big cities in 25 industries including machine tools, automobile parts, scientific instruments, and some electronic components.
- Manufacturers of motor vehicles, paper products and some types of machinery and electronic goods may now vary their product mix within broad categories -- manufacture automobiles instead of trucks, for example. They must still seek government permission before investing in any additional capacity.
- Anti-monopoly legislation, which imposes additional restrictions on production and investment, will now apply to only about 800 corporations, compared with more than 3000 in 1984.

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- o Small firms may now triple their sales and almost double their investment without losing tax exemptions or becoming subject to the industrial licensing system.

- o The government department that supervises private corporations has been shifted from the Ministry of Law and Justice to the Ministry of Industries, whose bureaucratic bias favors production rather than restraint. [redacted] 25X1

Businessmen also will benefit from a substantial reduction in corporate and personal tax rates and lower import duties on some machinery imports. According to press reports, businessmen are especially pleased that the government is beginning to plan tax policies for several years ahead. Still, the new budget approach combines cuts in business deductions with the lower tax rates; fiscal incentives will also be partially offset by other budget proposals that raise prices of essential items such as petroleum products and rail services, increase excise taxes on many manufactured goods, and restrict government loans to poorly managed or nonessential private corporations. [redacted] 25X1

The electronics industry is a major beneficiary of tax and control concessions. Production licenses will be issued far more freely than before, even to large companies and for consumer goods previously viewed as nonessential luxuries. Ceilings on output of micro and mini computers have been eliminated and import duty on components has been greatly reduced while high tariffs still protect domestic computer manufacturers. Development of mainframe computers and some high technology products will continue to be a government monopoly. [redacted] 25X1

- o ''Another turning point has arrived with...microelectronics and computers. In the earlier (industrial) revolutions, whoever got left behind found it extremely difficult to catch up...we must see that we are not left (behind).''

- o In '' basic scientific research we have achieved a lot. But we have been slow and not very good in transforming this into actual production.''

Rajiv Gandhi

Economic reform will hurt some businesssmen and workers, however. The Finance Minister has warned that the era of unbridled protection is over and the private sector should prepare for a ''bone breaking phase of development.'' Gan-

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dhi has commented that he would not be adverse to a shift from labor-intensive to capital-intensive industry -- a radical statement for an Indian leader, and one that was barely tempered by the proviso that workers be educated for other employment. [redacted] 25X1

Technology Emphasis in Foreign Trade and Investment

Indian policy statements promise easy access to imported technology, especially for electronics and export industries, and procedures for employing foreign technicians have been simplified. New Delhi has even emphasized that foreign equity investment -- previously tolerated but not encouraged -- will be allowed in electronics and oil exploration. [redacted] 25X1

Import licensing changes have been relatively cautious, however, combining liberalization to promote modernization and exports with safeguards for domestic manufacturers. [redacted] New Delhi has removed restric- 25X1
tions on some industrial machinery used by exporters and high technology industries, but also tightened controls on additional items that compete with Indian production. Trade guidelines have been announced for the next three years so that businessmen can plan ahead. [redacted] 25X1

Many export industries, particularly computer software, will benefit from liberalized import controls, lower import duty, and simplified procedures, but Gandhi apparently is relying primarily on improvement in overall industrial performance to make Indian exports more competitive in world markets. Other export promotion initiatives are surprisingly few in view of the emphasis Gandhi's economic advisers have placed on the need to earn more foreign exchange. Press reports suggest that new income tax concessions on reinvested export profits provide little additional incentive since: (1) they replace previous benefits linked to export sales and (2) they are no longer available for trade with the Soviet Union. A routine adjustment to world market conditions removes export taxes on several mineral and agricultural products. [redacted] 25X1

Indian economic policy still stresses self-reliance. Government approval is necessary before an Indian firm may purchase or lease foreign technology, even in industries recently exempted from industrial licensing restrictions, and domestic manufacturers are still required to reduce gradually their use of imported parts. They are also expected to develop their own research skills. New Delhi remains reluctant to open the Indian market to foreign investors who cannot contribute technology or promote Indian exports. [redacted] 25X1

[redacted] 25X1

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- ''India must be self-sufficient on all fronts. But...with these vast new technologies...we have to pick a few areas to come on par with the advanced countries.''

- ''We want a new dynamism in our economy, but we cannot do it entirely on our own....We need help from foreign business to help us build self-sufficiency.''

- ''It is not feasible to open up industry completely to free competition from other countries. It would not be fair to our industries.''

- On the role of foreign companies in India: ''We see them...in the high technology areas which we cannot develop ourselves.''

Rajiv Gandhi

Government Still in Driver's Seat

Gandhi clearly intends the government to retain control of the direction of the economy. While easing detailed regulations, he has retained the basic structure of import and industrial licensing, preferences for small producers, and close supervision of large corporate groups. He has even tightened controls in a few areas -- on pollution, for example, following the Bhopal disaster. Gandhi, while actively using policy tools -- which include selective liberalization -- to support his personal predilection for electronics and high technology, apparently has no plans to rely on market forces to allocate basic consumer goods and will continue the public distribution system that supplies grain to urban consumers and supports prices farmers receive for wheat and rice. [redacted] 25X1

Gandhi hopes to make the bureaucracy more efficient, not less important. Within his own secretariat, he has increased the number of senior civil servants who will help shape economy policy. Gandhi has repeatedly emphasized decentralization of decisionmaking so that public sector corporations can make business decisions without interference from government ministries. Indian industrialists report that bureaucratic approvals for private projects can be obtained more quickly than in the past -- perhaps because Gandhi has ordered that no file be reviewed more than twice. [redacted] 25X1

[redacted] 25X1

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- On reform within the bureaucracy: ''Rules and procedures will be drastically simplified to speed up decisionmaking. Results will take precedence over procedures....A strong concern for efficiency must permeate all institutions.''

Rajiv Gandhi

Gandhi's concern for bureaucratic efficiency -- and government revenues -- has also prompted an anti-corruption drive since he came to power. Many business enterprises were raided during the state election campaign to obtain information about smuggling and illegal payoffs; rewards for information about smuggling have been increased; and corporate contributions to political parties are once again legal. According to press reports, some businessmen were surprised to discover that payoffs could no longer influence excise tax policy. 25X1

Gandhi's main approach to convert unreported earnings into taxable income is to lower tax rates and relax some of the controls that led businessmen to conceal part of their production and income. Many Indian journalists remain skeptical of Gandhi's ''Mr. Clean'' image, however, and question whether he will forgo payoffs on large contracts that help fund the Congress Party. 25X1

Economic Policy Still Evolving

The strength of Gandhi's resolve to create a more competitive economic environment is yet to be tested. Despite his hints that some hardship is an acceptable price for efficiency, Gandhi has retained substantial protection against imports and may slow the pace of domestic decontrol if unemployment mounts or business confidence weakens. In addition, his liberalization program will be put to a severe test if, as promised, he decentralizes implementation, since India's bureaucrats are notoriously cautious and jealous of their authority. 25X1

Policy statements expected during the next several months will help define Gandhi's commitment to economic liberalization. Press reports suggest that a revised industrial policy will focus on chronically unprofitable firms in both the public and private sectors, and may modify regulations that limit industrial expansion in urban areas and subsidize investment in 'no industry' districts. Gandhi assured a meeting of international business leaders that he will ease foreign investment rules further. Details of the next Five Year Plan and of agricultural policy, scheduled for release by July, will clarify government in-

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vestment and welfare plans. Reforms in education -- one of Gandhi's special interests -- will not be proposed until next year. [redacted] 25X1

Economic and Political Impact

Gandhi's policy reforms and his pro-business image do not assure faster overall growth. His decontrol moves directly affect only a small share of the Indian economy --primarily exporters and corporations that produce capital equipment and consumer durables. Even if liberalization is extended substantially, substantial overall growth can be realized only if shortages of electricity become less severe and agricultural output increases sufficiently to sustain domestic demand for manufactured goods. Perhaps most important, forthcoming balance-of-payments strains may block India's ability to import goods needed to modernize and increase production. [redacted] 25X1

Balance-of-Payments Constraint

In our view, there are several factors pointing to increasing balance-of-payments strains that could jeopardize India's ability to become more productive and efficient. Although international financial reserves are now adequate -- about $6 billion, equivalent to four to five months imports at the 1984/85 rate -- expansion of the domestic economy would require a much faster growth in the volume of imported petroleum and capital goods. Scheduled payments to the International Monetary Fund and military suppliers will mount sharply within the next two years. Wary of falling into a debt trap, Gandhi and his economic advisers are reluctant to risk a substantial increase in commercial borrowing to finance imports. We see a less than even chance for discovery of additional petroleum deposits, rapid export growth, or improved foreign aid prospects, which would provide a more favorable balance-of-payments scenario. [redacted] 25X1

Mounting criticism that Gandhi is slighting the poor in favoring India's small middle class may emerge as a significant political issue. Large cuts in taxes on personal income, wealth, and inheritance directly affect less than three percent of the population; indirect tax hikes and the large budget deficit threaten inflation that will affect most people's pocketbooks. Moreover, few will be able to afford products from the new boom sectors -- automobiles and electronic goods. Central government spending on welfare and rural development programs is stagnating. Although Gandhi says that reducing poverty is his primary objective, his enthusiasm lies with middle class issues. [redacted] 25X1

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Implications for the United States

Gandhi's economic approach will accelerate interest in business ties with the United States. A window of opportunity has been opened for US trade and investment. It may last only two years or so, however, until balance-of-payments strains mount and domestic producers clamor for protection while they assimilate recently acquired foreign technology. 25X1

At the same time, the potential for bilateral misunderstanding and friction is high. Gandhi and his new team of economic advisers bring with them a belief that the United States is an unreliable supplier. Their new sense of urgency about modernization suggests they will turn to Japanese or European suppliers promptly if US export controls remain a significant trade barrier despite recent negotiation of a memorandum of understanding with the United States on technology transfer. 25X1

Indian officials already contend that economic liberalization, which the United States has encouraged, can continue only if concessional aid receipts remain high. If balance-of-payments strains limit India's ability to modernize, they will probably blame the United States for limiting Indian borrowing from multilateral lending institutions. 25X1

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